

## GLOBAL MULTISECTOR FINANCING PROGRAM

(BR-0277)

### EXECUTIVE SUMMARY

**BORROWER:** Banco Nacional de Desenvolvimento Econômico e Social (BNDES)

**GUARANTOR:** The Federative Republic of Brazil

**EXECUTING AGENCY:** Banco Nacional de Desenvolvimento Econômico e Social (BNDES)

**AMOUNT AND SOURCE:** IDB: Ordinary Capital (OC)  
Formalizing and consolidating  
microenterprise and small-scale businesses  
component (BR-0289)US\$ 150 million  
SME component (BR-0277) US\$ 750 million  
Private social services  
delivery component (BR-0290)US\$ 200 million  
**Total IDB:US\$1,100 million**  
Borrower:US\$1,100 million  
**Total: US\$2,200 million**  
Currency:United States dollars

**FINANCIAL  
TERMS AND  
CONDITIONS:** Amortization period:20 years  
Disbursement period: 4 years  
Interest rate:variable  
Inspection and supervision:1%  
Credit fee:0.75%

**COFINANCING:** The Export-Import Bank of Japan (JEXIMBANK) has communicated its interest in cofinancing the operation in an amount of up to US\$900 million, in two equal stages, covering exclusively the borrower's contributions for the credit component for SMEs and the component for formalizing and consolidating microenterprises and small-scale businesses. Negotiations are well advanced, and the amount of JEXIMBANK financing is expected to be firmed up during the course of this year.

**OBJECTIVES:** The general objective of the program is to support:  
(i) development and modernization of Brazil's productive sector, by expanding medium and long-term financing on market terms for private investment projects aimed at restructuring, improving and expanding efficient activities of microenterprises, small-scale businesses, and small and medium-scale enterprises; (ii) facilitated formalization and financial consolidation of microenterprises and small-scale businesses, to give them access to medium- and long-term financing by intermediary financial institutions (IFIs), and help them meet their tax, labor, social security and environmental obligations; (iii) better access to long-term financial resources for private investment projects for increasing the coverage and improving the quality of private services in higher education and health;

and (iii) development of the financial market that was initiated under the previous program by providing liquidity for introducing and developing new and more sophisticated products for private investment projects. In line with that previous operation, the program will support Brazilian government efforts to modernize productive sectors and make them more competitive by reducing the so-called "Brazil cost". The proposed operation will continue support for development of the financial market, in accordance with guidelines for the Bank's programs in the financial area.

**DESCRIPTION:**

The proposed program will consist in providing global multisector financing under three components. The first focuses on financial support for formalizing and consolidating microenterprises and small-scale businesses included in the SIMPLES system. The second component emphasizes financing for modernizing and expanding small and medium-sized enterprises (SMEs) to enhance their competitiveness in a more open economy. The third component will help strengthen the private delivery of higher education and health services.

Support for formalized microenterprises and small-scale businesses, in particular, will help to regularize their tax status and bring them into the mainstream economy, enhance their access to financing from the financial system, and contribute to effective operation of the country's programs in support of women and of environmental and health controls. As well, the program will encourage development of new financial products and market facilities for the business segments in question.

The program consists of a loan to be totally executed by means of three rediscount facilities for medium- and long-term financing, through IFIs declared eligible by BNDES. The projects to be financed by way of these operations must meet the technical, financial, economic, legal and environmental requirements of the program. The first window (BR-0289, US\$150 million) for formalizing and consolidating microenterprises and small-scale businesses is intended as a credit facility for: (i) microenterprises (including working capital), up to US\$25,000 per transaction, and small-scale businesses (including working capital), up to US\$144,000 per transaction. The facility is intended to help these enterprises, in both the producing and service sectors, to gain access to adequate financial services and to help modify the practices of the IFIs with respect to providing credit to microenterprises and small-scale businesses. NGOs that lend to microenterprises may also access these credits, if they are declared eligible by BNDES under Bank-financed technical-cooperation project ATN/SF-1128/BR being executed by BNDES. The second window (BR-0277, US\$750 million) is intended as another rediscount facility for providing financing of up to US\$3 million per transaction to small and medium-sized enterprises (SMEs) for capital investments in modernizing and expansion projects in nearly all

manufacturing and service activities. The third window (BR-0290, US\$200 million) would be a further rediscount facility for providing financing of up to US\$15 million per transaction for strengthening private providers (other than SMEs) of higher education and health services.

All of the resources under the program will be channeled by BNDES through IFIs declared eligible under criteria established in each of the program's sets of Credit Regulations, which, as in previous operations, are consistent with the operating rules of BNDES. Those IFIs will use these resources in turn to grant credits to finance the purchase, installation and start-up of capital goods in areas covered by the three components described above.

**RATIONALE FOR  
THE OPERATION:**

There are currently a number of serious constraints on the availability of medium- and long-term financial resources to meet the needs of microenterprises, small-scale businesses and SMEs, in both financial institutions, which avoid medium- and long-term exposure with short-term deposits and the capital market, which, from a practical viewpoint, is generally restricted to large corporations. A similar situation is facing private providers of services in the higher education and health areas. The only significant source of this type of financing for microenterprises, small-scale businesses and SMEs are the credit programs offered by BNDES.

The selection of BNDES as the executing agency offers access to that institution's Brazil-wide network of IFIs, the only one in the country that has the coverage to ensure that the program's resources will filter to a large number of end-borrowers throughout the country. Moreover, it has the procedures, standards and institutional capacity for evaluation and supervision that are needed for sound operational management of a program of the size proposed here.

In the framework of the special relationship between the IDB and BNDES, new products will be developed, such as leasing, which BNDES has already launched, guarantee funds, credit insurance for microenterprises and small-scale businesses, etc.

**ENVIRONMENTAL AND  
SOCIAL REVIEW:**

The design of the proposed program is consistent with the environmental requirements already established in the previous operation, which have been proven satisfactory. Those requirements include a comprehensive mechanism for monitoring the environmental quality of subprojects based on the environmental standards of the National Environment Commission (CONAMA). That mechanism, which is now applied in all BNDES loans, has worked well in the previous SME operation, in which there were very few subloans that had an environmental impact, and effective control measures were taken in every instance. The present program will therefore maintain the mechanism without major changes, while incorporating the recommendations that came out of the evaluation conducted by BNDES. The IFIs will not onlend for activities classified as having a negative

impact unless their design includes a timetable for mitigation measures to give effect to the environmental undertakings of the subborrowers.

**POVERTY TARGETING:** Window BR-0289, for formalizing and consolidating microenterprises and small-scale businesses, automatically qualifies as a poverty-targeted project. The SME window (BR-0277) and that for private social service providers (BR-0290) are not, by their nature, considered to be targeted on poverty.

**EXCEPTIONS TO  
BANK POLICIES:** None

**PROCUREMENT:** Not applicable

**BENEFITS:** The growing competition coming from within MERCOSUR and from the globalization of markets demands financial intermediation and, in particular, the availability of medium- and long-term financing to increase the competitiveness of Brazil's microenterprises and small-scale businesses and its SMEs, which together represent an important part of the country's industrial plant, and have the potential to restructure and modernize for exports. To this end, the component for financing SMEs will promote: (i) extending the coverage of medium- and long-term finance to all efficient private sector activities, including social-sector operations; and (ii) the development of medium- and long-term financing mechanisms and instruments, for small and medium-sized enterprises.

Similarly, the component for formalizing and consolidating microenterprises and small-scale businesses will enhance (i) the efficiency and competitiveness of this group of businesses, and (ii) expand and consolidate its access to credit for the purchase of capital goods and for working capital.

With respect to the component for credit to private higher education and health service providers, the principal direct benefits will derive from expanding the supply of services and extending their coverage, especially for low-income groups. In higher education, the benefits will depend on the extent to which private providers respond to the educational needs of students with a more diversified income profile than do the public-sector institutions. In health, benefits will consist in increasing access for people of few means to effective, high-quality services.

Given the nature of the operation to provide financing for all efficient, private-sector activities in all sectors, it is impossible to produce an ex ante measurement of the specific outputs, either at the macroeconomic level (GDP, exports) or in terms of the number and amounts of the subloans and the size of the subborrowing enterprises. However, previous experience with BNDES operations supports achievement of the proposed objectives, the arrangement selected, and BNDES's

capacity to implement the operation.

**RISKS:**

Successful implementation of the proposed program will depend on maintaining a macroeconomic and financial framework that is conducive to the growth of private investment. In this respect, the government has already achieved noteworthy results in terms of economic reforms and stabilization under the *Plano Real*, and has reinforced these with the package of measures announced in late 1997 and early 1998, which reduce the risk of speculative runs on the *real* and will help to consolidate progress under the *Plano Real*. Under these circumstances, the macroeconomic risk is considerably reduced. In addition, the experience that BNDES has gained in programs of this kind, operating under much more difficult macroeconomic conditions, gives assurance of its capacity to manage the macroeconomic risks.

The risk of disruptions in the financial system is low, given the restructuring that has occurred since the introduction of the *Plano Real*, which has entailed consolidation of the financial system, the strengthening of regulatory and supervisory mechanisms, and the reorganization and/or privatization of part of the State banking system, all of which provides grounds to expect that the resources of the proposed program will be channeled to good use. In addition, it should be noted that the proposed program will help to mitigate this risk by acting as a catalyst for sound practices, by insisting on more rigorous application of selection mechanisms and portfolio monitoring by the IFIs, and in the surveillance that BNDES will exercise over the IFIs' lines of credit. As well, by placing long-term funds at the disposal of the IFIs, the proposed program will facilitate more balanced growth of their lending portfolios.

The past experience of BNDES and its proven effectiveness in funneling credit to a large number and variety of SMEs will significantly reduce the risk that the program may not fully reach its target groups, or that the operation will not achieve the anticipated results.

Finally, with reference to the component for private social-services providers, and more specifically the health subcomponent, there is a risk that technology costs will translate into social costs, in situations where private providers fail to rationalize their service costs. This risk can be reduced at the time BNDES conducts its technical and financial review of loan applications submitted by accredited IFIs.

**ROLE OF THE  
PROJECT IN THE  
BANK'S COUNTRY AND  
SECTOR STRATEGY:**

The proposed program is consistent with the Bank's financing strategy for Brazil, which addresses the challenges identified in the country paper. It accords with the policy guidelines and principal goals of the government and the priorities established by the Brazilian authorities in response to the request from BNDES to the Ministry of Planning (SEAIN) of March 19, 1997. That request was included in the Bank's programming pipeline as one of the

priority projects for 1998. The Bank's strategy for 1996-1998 calls for three basic areas of action: (i) reform and modernization of the State; (ii) modernization of production and reduction of the "Brazil cost"; and (iii) addressing social inequities and poverty. The proposed operation addresses item (ii), in the sub-area of the financial sector, and item (iii) in the sub-areas of reducing social inequities and urban poverty, and the education and health sectors.

The program will also be used for technical exchanges between the IDB and BNDES to develop new financial products, disseminate BNDES's second-tier methodology, and devise new market pricing methods.

**SPECIAL  
CONTRACTUAL  
CONDITIONS:**

Prior to the first disbursement of resources allocated to each component of the program, the borrower will submit evidence that the Credit Regulations for the component are in force and that they include: (i) eligibility conditions and parameters for IFIs and their subborrowers, as well as their contractual relationship with BNDES; (ii) the financing charges for the IFIs, which will be calculated on the basis of the "long-term interest rate" (TJLP), adjusted quarterly, plus an onlending fee of 2.5% for SMEs and 1.0% for microenterprises and small-scale businesses, and for the social component, in all cases covering the institution's operating costs; (iii) the provision that IFIs will be free to set their interest rates, fees and other charges on their subloans under each component; and (iv) mechanisms for monitoring the IFIs and their transactions under each component of the program, by BNDES.